Commentary on the Faraday Case

12 February 2019

The Council undertook, over a period of several years, and in reliance upon expert professional advice, a full and substantial tender process to select a joint venture partner to regenerate the London Road Industrial Estate. The regeneration, in common with many such projects, was set to be a long-term and complex process. The Council's objectives were to encourage regeneration and employment and enhance its income from its freehold interests in the estate. Following a substantial advertisement campaign in major estate journals designed to widely publicise the opportunity, the Council received multiple enquiries, culminating in a long list of 12 potential partners, subsequently reduced to a short list of 6 and, ultimately, 3 viable potential candidates. The Council had put in place a cross party working group consisting of councillors and officers who were involved throughout the tender process.

The Council treated the joint venture as a land deal with the joint venture partner eventually selected, St Modwen. The legal arrangements were contained in a development agreement, structured so that the St Modwen had no obligation to bring forward land on the estate for development and no direct obligation to carry out works on the land. St Modwen were appointed to land assemble (bring forward plots) on the basis of the Council objectives of regeneration and as and when they could negotiate land deals with the tenants, where supported by a financial case. Although St Modwen were under no obligation to bring forward plots, even if they did so the ultimate decision to acquire those plots lay with a steering committee formed of Council officers and members and representatives of St Modwen. There was no works specification or scope of work attached to the agreement.

A junior partner attached to one unsuccessful bidder, Faraday, challenged the Council's choice of development partner. Faraday had formed a consortium with one of the 3 potential candidates to bid for the opportunity. Its consortium partner did not participate in the litigation or otherwise challenge the Council. Faraday made a series of wide-ranging allegations about the lawfulness of the Council's decision to enter into the development agreement, including that the Council had failed to secure best consideration for the disposal of its land and that the development agreement was a type of contract that was required to be procured via a regulated process. The Council sought advice from a leading QC and proceeded with defending the challenge.

The High Court rejected each and every aspect of Faraday's challenge. It concluded that the development agreement was not a public works contract or otherwise an arrangement that fell within the scope of the public procurement rules. The High Court noted that the development agreement did not impose any binding obligation on St Modwen to acquire land or carry out works to redevelop the estate; as such St Modwen was free to walk away. The judge identified that the development agreement was an arrangement analogous to an option arrangement – a type of contract that the Faraday accepted fell outside the scope of the regime. He considered that the effect of the existing leading European (Helmet Muller) and domestic (R(on the application of Midlands Co-operative Society Ltd) v Birmingham Coty Council) case law was that a contract of this type could not fall within the regime unless (i) its main purpose corresponds to one of the definitions of a "public contract" found in the Directive and (ii) the developer was under an enforceable obligation to carry out that main purpose.

Faraday appealed to the Court of Appeal in relation to only one of its original grounds, relating to whether the development agreement was the type of contract that needed to be procured. It developed a series of new arguments in relation to that challenge. It also abandoned its previous assertions about best consideration and other public law breaches. The Council again sought the advice of a leading QC again and proceeded to defend the appeal.

The Court of Appeal found that although the existing case-law made clear that a contract will not fall within the definition of a public works contract unless the developer had assumed an obligation, it did not resolve the question of whether that obligation had to be immediately enforceable. The Court of Appeal found that it was necessary to look at the substance of the contract and not merely its form, distinguishing between contracts for the sale of land without any (immediate or contingent) obligations to carry out works, and contracts which give, with some precision, the mechanisms for carrying out works where a council retains some control over their content and execution.

The Court of Appeal stated that the development agreement was not a public works contract at the point it was entered into. It was right to read into the case-law the notion that a contingent obligation was not a relevant obligation for the purposes of defining a public works contract.

However, the Court of Appeal decided that the development agreement contained a commitment on the Council to entering into binding arrangements if and when St Modwen exercised its option to bring forward land, which would in turn oblige the developer to carry out works. The Court of Appeal found that that this would in substance comprise a transaction that on its own terms would satisfy the requirements of a public works contract. It noted that the Council had effectively agreed to act unlawfully in the future. That was because the development agreement would in those circumstances lead to a relevant procurement, i.e. a procurement that ought to have been conducted under the public procurement rules, of a public works contract without that public tender process having taken place.

The Court of Appeal dismissed the alternative grounds relied upon by Faraday, namely whether the public procurement rules had been deliberately and unlawfully avoided and whether the development agreement was a public services contract.

The Court of Appeal concluded that the Council had not acted in bad faith nor sought to mislead as to its intentions, and nor was it unlawful for the Council to seek to achieve a contractual relationship with a developer outside of the scope of the public procurement regime. The Court also concluded that the fact that the development agreement contained immediately enforceable obligations to carry out ancillary services that were not the main object of the contract did not, consistently with the existing European case-law (Hotel Loutraki and Commission v Spain), render it a public services contract.

By operation of the Public Contracts Regulations 2006 the Court of Appeal was required to decide on remedies and make a declaration of ineffectiveness. It did make a declaration which meant that Council could not continue with the development agreement. The Court of Appeal in exercising its powers ordered to pay a civil financial penalty of £1 to the Cabinet Office.

There are notable differences when undertaking tendering under the Public Contracts Regulations 2006. The Council has an obligation to advertise in an Official Journal of the European Union and follow prescribed procedures to conduct tendering. The Council at all stages took legal advice and in its efforts to ensure that its intention to award the development agreement was widely communicated published a voluntary transparency notice on the Official Journal of the European Union right at the start. The Council observed a “standstill” period and allowed a month before signing the agreement. No challenges to the process were made during this period.

The Court of Appeal’s decision is a major shakeup as to how other schemes throughout this country and more widely European countries have been interpreted under the procurement directive and how councils will have to approach the procurement of development agreements.

The Council sought leading QC’s advice on the prospect of directly appealing the decision at the Supreme Court. The Council decided that it was expedient and efficient to go out to the market and appoint a joint venture partner. It is now developing plans to do so.